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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 92-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263
	)	

COMMENTS OF SPECTRANET INTERNATIONAL, INC.

SpectraNet International, Inc. ("SNI"), by its attorneys, respectfully submits these comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM" or "Notice") on access charge reform.[1]

INTRODUCTION & SUMMARY

The NPRM proposes to focus the Commission's access charge reforms initially on incumbent local exchange carriers ("LECs") subject to price cap regulation. *See* Notice ¶ 50. Because incumbent price cap LECs account for the vast majority of all interstate switched and special access services -- and because these LECs also serve most of the geographic areas in

[1] *Access Charge Reform,* Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 96-488 (released Dec. 24, 1996)("NPRM").

which competitive local exchange entry is likely to occur in the near term -- this approach is plainly correct. At the same time, however, in establishing access charge rules for incumbent local exchange carriers ("ILECs"), the Commission must be sensitive to the needs of other local exchange participants, particularly competitive local exchange carriers ("CLECs"), in order to ensure competitive parity and maintain incentives for efficient market entry.

SNI is a facilities-based CLEC, certified by the California Public Utilities Commission, that is presently deploying broadband, fiber-optic networks in several major California urban and suburban markets. This is a mammoth undertaking, requiring not only very substantial capital resources, but also significant investments for network engineering and construction, regulatory compliance, business planning and market forecasting, among others. Like other CLECs, SNI plans to offer interstate switched and special access services, in competition with Pacific Bell and other ILECs. In a very real sense, therefore, liberalization of the access charge rules applicable to price cap ILECs will directly affect the scope, timing and economic feasibility of facilities-based competition in local exchange markets.

The Notice seeks comment on the effect of the Commission's proposals on new entrants, *see, e.g.,* NPRM ¶ 53, but is not entirely clear whether the Commission contemplates exempting CLECs and other new local exchange entrants from the access charge regulations applicable to ILECs. For instance, in its Regulatory Flexibility Act analysis, the Commission suggests that "Section II" of the NPRM proposes "to exempt new entrant LECs from some or all of the regulations applicable to incumbent LECs." NPRM ¶ 337. On the other hand, Section VIII of the Notice indicates that regulation of terminating access services by CLECs may be necessary "because these new entrants appear to possess market power over IXCs needing to terminate calls." NPRM ¶ 279.

SNI believes strongly that CLECs should be exempt from the Commission's access charge rules, both those applicable to price cap and rate-of-return regulated ILECs. The realities of local exchange competition are that CLECs, for the foreseeable future, will remain price followers, keying their rates to those of ILECs, and will lack the subscriber base and traffic volumes that are the minimal predicates to any attempt to raise terminating access prices unilaterally. In fact, the Notice's suggestion that CLECs could exercise market power against IXCs (NPRM ¶¶ 271, 279) *is backwards.* In the full relationship between access provider and customer, IXCs clearly have the leverage to impose unreasonable -- and possibly uneconomic -- switched and special access rates on CLECs as a condition of interconnection. Thus, while the Commission can justifiably rely on the complaint process to ensure that CLEC terminating access rates are just and reasonable, in order to promote the market-based access charge regime proposed in the Notice, it must also make clear that the interconnection obligation of Section 251(a)(1) of the Act[2] requires IXCs to interconnect with all LECs, including CLECs, for both switched and special access.

I. THE COMMISSION SHOULD FASHION A REASONABLE TRANSITION PERIOD FOR IMPLEMENTATION OF NEW ACCESS CHARGE RULES FOR INCUMBENT PRICE CAP LECs

The Commission has suggested that there may be a need for transition periods in many of the reform proposals put forward. For example, the NPRM seeks comment on a transition mechanism for revising the transport interconnection charge ("TIC") in order to reflect "the extent to which IXCs must make adjustments to their network configurations in response to any revised TIC recovery methods." Notice ¶¶ 115. Additionally, the NPRM's proposed prescriptive approach to reform includes transition mechanisms in light of the possibility of "substantial cost difference" between LEC embedded and forward-looking costs, in order to meet the

[2] 47 U.S.C. § 251(a)(1).

interests of LECs in recovering at least some of their historic costs. Notice ¶ 239. Indeed, the phased approach proposed by the Commission for market-based reform mechanisms is itself a reflection of the need for a measured transition from strict regulatory control to market determination of access charge rates and rate structures. Notice ¶ 161.

The necessity for a transition mechanism applies as much to CLECs as it does to LECs and IXCs. In fact, because the 1996 Act and Commission policy rely on CLECs to provide a competitive check on LEC access charges, SNI believes that the interests of CLECs in a predictable, and fair, transition to pure cost-based access rates deserve important consideration by the Commission. Immediately flash-cutting access rates down to LEC cost, as a result of either regulatory mandates *or* premature (and anticompetitive) LEC price discrimination under a market-based approach, will undermine the basis upon which CLECs have been planning local telephone market entry. In the long run, of course, local exchange competition requires all carriers to compete on the basis of cost and relative efficiencies; yet in the short run, competitive local entry will be delayed if the Commission mandates an immediate reduction in LEC access charges without a reasonable transition period for new entrants to adjust to a more forward-looking pricing environment.

Competition in the local exchange market is in its infancy. Many new competitors, including SNI, have invested heavily in local exchange markets and are continuing to do so, based on market entry analyses that reflect current LEC access rates. While proper business planning must clearly anticipate both incumbent competitive responses and possible regulatory change, the sheer magnitude of the access charge reductions proposed in the NPRM are unprecedented. Forward-looking costs themselves are also the subject of considerable regulatory debate and

empirical contention, making business case projections for TELRIC-based competition highly problematic. As the Notice appears to recognize, it would seriously inhibit local exchange competition to send CLECs "back to the drawing boards" for their business cases on market entry, at this crucial point in regulatory reform. *See* NPRM ¶ 219 ("market disruptions" could occur if interstate rates are moved to forward-looking costs on "flash-cut" basis).

II. HIGH-CAPACITY SPECIAL ACCESS SERVICES SHOULD NOT BE REMOVED FROM PRICE CAP REGULATION IN THE ABSENCE OF A SPECIFIC ILEC SHOWING OF SUBSTANTIAL COMPETITION

The Commission seeks comment on whether to remove price cap regulation "immediately" for high-capacity special access services offered at speeds of DS1 or higher. Notice ¶ 153. This is not the right approach to access charge reform for these services. The concept of eliminating price regulation of high-capacity special access services is based on the *unsubstantiated* contentions of ILECs that there is already of "intense competition" for these services. Indeed, acknowledging a vacuum of data on the issue, the NPRM specifically requests "quantification" of the degree of competition that exists for these services. *Id.*

This quantification must come from the incumbent LECs, and is a necessary predicate to any relaxation of pricing rules for high-capacity services. SNI does not believe that the Commission should remove high-capacity special access from price cap regulation in the absence of a specific ILEC showing of substantial competition. Although competition is clearly increasing for high-capacity access, it is patchwork and sporadic at best. Therefore, LECs must be put to burden of demonstrating actual competition in specific geographic markets prior to wholesale removal of high-speed special access from rate regulation. These showings, whether

structured as waivers, declaratory rulings or some other procedural mechanism, should be made on a market-by-market basis.[3]

It is illuminating that the Commission has not proposed to remove "new technologies" from price cap regulation when deployed by incumbent LECs. *Compare* NPRM ¶¶ 139 and 199. This is clearly correct. While SONET, ATM and AIN are all technologies that can reduce access costs for incumbent LECs (and CLECs), these technologies are used to provision inter-state access, but are not access services in themselves. Thus, for instance, as part of any incremental, forward-looking cost estimate, the use of new and more efficient technologies will reduce the benchmark costs used in prescriptive access charge ratemaking. By the same token, deployment of such cost-reducing technologies by CLECs and other access competitors will place pressure on LECs to reduce their own costs through improved technology in order to avoid loss of market share. Accordingly, there is no need to make any special provision for "new technologies" in the Commission's access charge rules, and no justification for exempting new LEC-deployed access technologies from price regulation.

III. CLEC SWITCHED AND SPECIAL ACCESS SERVICES, INCLUDING TERMINATING ACCESS, SHOULD BE EXEMPT FROM BOTH PRESCRIPTIVE AND "COMPETITIVE TRIGGER" MARKET-BASED REGULATION

There can be no question that CLECs have little market share, and no market power, in virtually all local exchange and access services. Currently, the Commission presumes that new entrants into the exchange access market are non-dominant because they lack the ability to exercise market power in particular areas. Notice ¶ 278. The NPRM correctly indicates that the

[2] The procedural differences between the various administrative mechanisms suggested for such LEC showings are less important than ensuring the best market data for Commission analysis. Therefore, the Commission should require that LECs seeking to exempt high-capacity special access services from price cap regulation serve a copy of their FCC filing on all certified providers of local exchange and access services in the geographic market(s) encompassed by their filings.

policies developed during the *Competitive Carrier* proceeding requires this Commission to maintain the presumption that CLECs are non-dominant until proven otherwise. *Id.* ¶ 277. The Commission's "reluctance" to impose price regulation on non-dominant carriers (*id.* ¶ 278) is well-placed, and should be implemented by expressly exempting CLECs from access charge regulation. *See* page 2 above.

Despite the Commission's consistent treatment of CLECs as non-dominant carriers, the NPRM nonetheless questions whether CLECs enjoy market power over IXCs for terminating access services. Notice ¶ 279. This question should not be answered in the abstract. The theory that CLECs could potentially charge IXCs excessive prices for terminating access because IXCs have no control over the called party's choice of local service provider does not necessarily apply in practice.

The NPRM's analogy between ILECs and new entrants with respect to terminating access is flawed. For a number of reasons, the competitive circumstances facing CLECs are radically different from ILECs:

A. Price Competition. CLECs must meet or beat LEC rates and rate structures in order to successfully enter the local market. This reality means that the technical and administrative costs/burdens of separate terminating access rates, and accounting and billing special terminating switched access rates, will in many cases outweigh any potential benefit to the CLEC. Indeed, SNI and other CLECs have, to date, uniformly matched or under priced LEC terminating access rates in their filed tariffs.

B. Special Access Substitution. CLECs are likely to gain market share slowly, and initially those gains will be mainly in special access services, not switched access, for which IXCs can relatively easily substitute other terminating service providers (including ILEC, CAP, other

CLECs or self-supplied facilities). If CLECs raise terminating switched access rates, they also decrease the economic "break point" at which special access becomes feasible for IXC customers. This is especially true since CLECs will serve larger corporate customers in the first instance, which allows IXCs to more easily substitute terminating special access for any excessive switched access rates.

C. Unbundled Loop Substitution. CLECs have no more reason than LECs to encourage IXCs to provide local exchange services. Yet plainly, artificially high switched access rates will force more IXCs into the market by making it more economically feasible for an IXC to serve a given geographic market by integrating unbundled local network elements with its long distance services. Therefore, unbundled loop prices will serve as an effective constraint against unwarranted increases in terminating access, because such increases would create an economic incentive for IXCs to substitute unbundled network elements for CLEC switched access services. *See* Notice ¶¶ 48, 170.

D. IXC Leverage Over CLECs. ILECs have the subscriber base and traffic volumes that give them substantial bargaining power over IXCs, while, in contrast, most CLECs have nothing to leverage. In fact, the practical reality is that in the full range of the CLEC-IXC relationship, it is often the IXC that has far more power to dictate price to the CLEC than vice-versa. For instance, some IXCs have routinely demanded substantial discounts off of ILEC rates for special access as a condition of interconnection, and are indicating that they will require similar discounts on switched access in order to warrant interconnection with unaffiliated CLECs. The larger the IXC (and the more important its services are to CLEC customers), the more economic power the IXC has to effectively set access prices charged by CLECs.

All of these factors indicate that CLECs do not, as a practical matter, enjoy the same degree of market power as ILECs with respect to terminating switched access prices. Therefore, in light of the limited risk that CLECs could overcharge IXCs for terminating switched access, the Commission must weigh the costs of imposing rate regulation on CLECs against the need, limited if any, to exercise control over CLEC pricing. The complaint process that underlies the *Competitive Carrier* model would work fine for regulating terminating CLEC access. The IXCs will surely "cry foul" if they feel they are being manipulated and squeezed by either CLEC or ILEC prices. The Commission can then analyze the reasonableness of CLEC charges in order to judge the validity of the IXC claim.

The same is not true, however, of IXC exercise of power over the CLECs. If the Commission permits IXCs to refuse to interconnect with CLECs without unilaterally dictated discounts in access charges, the ubiquity of the PSTN will be held hostage to IXC-CLEC price "negotiations." For this reason, Section 251(a)(1) should be applied -- as it expressly requires -- to impose interconnection obligations on *all* telecommunication carriers, including IXCs, for both switched and special access services. At the very least, if the Commission concludes that CLECs are dominant for terminating access, it should also recognize that IXCs have a measure of offsetting economic power as well, and mandate IXC interconnection with all CLECs. Since it is clear that any pricing power CLECs may enjoy vis-a-vis IXCs arises in only a very small portion of all the services they will offer, the better course is to allow the marketplace to emerge and then take whatever steps -- either on a carrier specific or generic basis -- may be necessary to ensure a long term, effective, competitive environment.

IV. THE COMMISSION SHOULD NOT ESTABLISH A RATE "BENCHMARK" FOR CLEC TERMINATING ACCESS

The NPRM invites comment on whether, if the Commission finds CLECs have market power in terminating access, it should use ILEC terminating access rates as a price benchmark, requiring cost justification by CLECs for rates exceeding the benchmark. NPRM ¶ 280. This approach is inappropriate because CLECs have very different costs than their ILEC competitors. For example, construction costs of CLEC networks may, in some instances -- *e.g.,* dense urban markets with substantial right-of-way expenses -- require that CLEC rates exceed LEC rates for some customers or some services. CLECs have substantial marketing and advertising expense to obtain even a fraction of the name recognition enjoyed by the incumbent. Even though the effect of these additional costs is likely small and transitional, they are nonetheless real, and CLECs must incur them to be competitive.

A benchmark would also impose substantial interstate regulatory costs on CLECs, because prices exceeding the benchmark by a *de minimis* amount would still trigger requirements for full cost support. Two less burdensome, but equally effective ways of policing terminating access rates -- if the Commission determines rate regulation is necessary -- would be (1) to allow for a "zone of reasonableness," *e.g.,* 20%, whereby CLEC terminating access rates could exceed comparable ILEC rates, in any geographic market,[4] without triggering cost support requirements, and (2) requiring that all LECs (both CLECs and ILECs) price terminating access the same as originating access in each applicable geographic market. The latter is preferable because it is far

[4] Because ILEC access rates can frequently differ, between providers (and thus geographic markets), by more than 20%, it would clearly be unfair to use the switched access rates of one ILEC as a rate "benchmark" for CLECs competing in a different ILEC's service territory.

easier to implement and conforms to the large proportion of switched access services available today. Under this approach, if a LEC desired to price terminating access at different rates than origination access (per rate element), it would first be required to petition for waiver of the Commission's access charge rules.

V. TARIFF AND CONTRACT FILING REQUIREMENTS FOR CLECs SHOULD BE CLARIFIED AND RATIONALIZED

The NPRM proposes that under the market-based regulation alternative, once the Phase I "trigger" has been met, ILECs would be permitted to offer services via publicly available contract tariffs. Notice ¶ 195. One obvious effect of allowing ILECs contract pricing will be the opportunity for below-cost and predatory pricing by incumbent monopoly providers. Although SNI lacks the resources to "quantify" the risk of LEC predatory pricing its concerns, as requested in the NPRM, *id.*, it believes that ILEC contracting authority for switched access services should be withheld until actual or substantial competition materializes.

If contract carriage is implemented by the Commission, however, this approach clearly needs to be assessed for competitive parity between CLECs and ILECs. Under its recent *Forbearance Order,*[5] the Commission concluded that interstate access services must still be provided under tariff. This includes CLEC access services. Yet CLECs merit at least as much flexibility to provide services via contract as LECs. In fact, since there is no question that CLEC price reductions are *always* procompetitive (because of their lack of market power), CLECs should be permitted to provide contract-based services *now*, without any predicate showing to the Commission of either potential or actual competition. Accordingly, subject to comparable

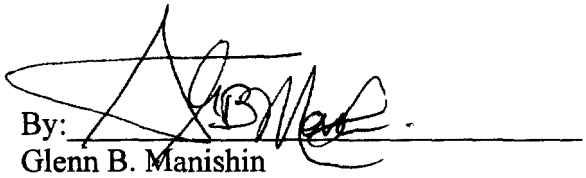
[5] *Policy and Rules Concerning the Interstate, Interexchange Marketplace,* Second Report and Order, CC Docket No. 96-61 (released Oct. 31, 1996).

public filing requirements, the Commission should clarify that CLECs can provide interstate switched and special access services on a contract basis.

CONCLUSION

The Commission must be sensitive to the need to promote efficient and procompetitive facilities-based local exchange entry in fashioning new access charge rules for incumbent price cap LECs. Competitive entrants should not be subject to price regulation, even for terminating access, and should be free to offer service immediately on a contract tariff basis.

Respectfully submitted,



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